

**Statement of John P. Higgins, Jr.
Inspector General
Department of Education**

**Before the
House Budget Committee
United States House of Representatives**

July 9, 2003

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify about waste, fraud, and abuse in the student financial assistance programs within the Department of Education (the Department). As you requested, I will address some of these problems, their general nature, and corrective actions that have been, or that need to be, taken. I will also provide illustrative examples of problems we have identified.

Most importantly, I want to urge Congress to amend the Internal Revenue Code to allow the Department to match the information provided on student applications with the income data that is maintained by the Internal Revenue Service (IRS). As I discuss more fully below, the Department currently estimates that \$336 million in Pell grants was improperly disbursed because applicants understated their income in fiscal year 2001.

I. Background on the Student Financial Assistance Programs

The Department's student financial assistance programs are large and complex. The loan and grant programs affect over 37 million individuals and involve 5-6,000 schools, more than 4,000 lenders, three dozen guaranty agencies, and many contractors. Last year the Department disbursed and guaranteed approximately \$65 billion and managed a \$267 billion loan portfolio for these programs. The size and scope of the programs have increased greatly in recent years, with total program dollars doubling in the last ten years alone.

These programs are inherently risky due to their complex design, reliance on numerous entities, and the nature of the borrower population. For example, borrowers are given access to federal loan assistance even though they may have no credit or employment history.

The student financial assistance programs have been on the General Accounting Office's (GAO) high-risk list since 1990. The Department has made a strong commitment to remove the programs from the list, and it is making progress toward this goal. Reducing risk in these programs is one of the Department's strategic goals, and a top priority for the Secretary who at the beginning of his tenure established a senior level management

team to resolve financial management issues throughout the Department and in these programs.

II. Estimated Magnitude of Waste, Fraud, and Abuse

You have requested that we provide specific dollar amounts of waste, fraud, and abuse in the Department's student financial assistance programs. We do not have a total, comprehensive estimate of these amounts.

The Department is required to provide to the Office of Management and Budget (OMB) annually erroneous and improper payment estimates, and in 2002 the Department reported \$401 million for student financial assistance programs. While we did not verify this figure, we think it is conservative.

We report on monetary results from our work in our Semiannual Reports to Congress. For the last five and one half years (October 1, 1998 through March 31, 2003), we reported more than \$182 million in total sustained questioned and disallowed costs from our audits of student financial assistance programs.

During the same period, we reported that our investigations in these programs resulted in restitutions, criminal fines, and civil actions totaling more than \$152 million. Of course, this represents only the waste, fraud, and abuse that we have been able to identify through our work, with our limited resources.

Following are some examples.

- During the last two years, we performed audits on nine guaranty agencies to assess the adequacy of their establishment of the Federal and Operating funds required under the Higher Education Amendment of 1998. These audits identified approximately \$164 million that should be recovered by the Federal government.
- In 1999, our audit of loan discharges based on death and disability found that over \$77 million in loans were discharged to borrowers who falsely claimed they were disabled or dead. ("Improving the Process for Forgiving Student Loans," ED-OIG/ACN: 06-80001; June 1999)
- Our audit of the 1995-96 award year found that over \$177 million in Pell grants was improperly disbursed because applicants understated their income on their applications. The Department updated and refined this estimate to \$336 million for fiscal year 2001. ("Accuracy of Student Aid Awards can be Improved by Obtaining Income Data from the Internal Revenue Service," ED-OIG/ACN: 11-50001; January 1997)

- Our investigation of a financial aid consulting business led to 411 settlements and civil judgments totaling over \$4 million. The owner of this business certified false Federal income tax returns to verify false income amounts that enabled ineligible students to qualify for financial aid. We identified over 700 students who used this service.
- A collection agency paid \$6.4 million in settlement of allegations that it submitted false claims for payment under its contract with the Department to collect defaulted student loans. The alleged false claims were based upon consolidated loans that did not meet legal requirements.

III. General Nature and Illustrative Examples of the Current Challenges

Based upon our work, we conducted an analysis of patterns of waste, fraud, and abuse in student financial assistance programs. We supplied this analysis, and suggestions for preventive measures, to the Department in March 2003. Implementation of our suggestions could save millions of dollars by preventing loans made to ineligible students, inappropriate loan discharges, abuse by guaranty agencies, and other types of mismanagement. Examples of the major issues we identified are provided in the following sections.

A. Fraud from Lack of Eligibility Verification

The Higher Education Act of 1965, as amended (HEA), requires applicants to provide eligibility information on their Free Application for Federal Student Aid (FASFA). Some applicants provide false information—for example, about their income or their dependency status—in order to receive funds for which they are not eligible.

1. Income Match

As I mentioned earlier, the Department currently estimates that in fiscal year 2001 \$336 million in Pell grants was improperly disbursed because applicants understated their income. The most effective way to detect this falsification is to match the information that applicants provide with the information maintained at the IRS. We have recommended this match since 1997.

Though a provision in the Higher Education Amendments of 1998 was intended to permit this match, no corresponding change was made to the Internal Revenue Code. The Department has worked with OMB and the Department of Treasury on the necessary changes to the Internal Revenue Code, and they were submitted to the Congress. This legislative authority is one of the single most significant steps that Congress could take to reduce waste, fraud, and abuse in student financial assistance programs.

During the 1990's we effectively used the process of computer-based matching of records to identify control weakness in the verification process for students applying for student financial assistance. In each of three successful matches, the OIG identified hundreds of

millions of ineligible awards, and recommended corrective actions to prevent future ineligible awards. In response to each audit, the Department implemented management and system controls to address the abuses.

2. Default Match

In March 1992, we reported on a weakness in the screening of FAFSAs, that we estimated could cost the Department and the taxpayers \$800,000 a day in ineligible funds being disbursed to previous defaulters. No edit check existed in the system controls to check for previous defaulters. In response, the Department quickly responded and implemented the edit check within three months of our report by matching applicants against the default data.

3. Death and Disability Match

In an audit in 1999, we identified approximately \$77 million in student loans that were discharged for total and permanent disability and death (\$73 million disability, \$4 million death), even though the borrowers were apparently not totally and permanently disabled or deceased according to Social Security Administration's Master Earnings file. Improper discharges occurred because of control weaknesses in the system for determining borrower eligibility for the disability or death discharge. We also found that 6,800 new loans totaling about \$20 million were awarded to borrowers who had previously received disability loan discharges totaling \$11.5 million. The Department implemented the following corrective actions:

- Borrowers requesting total and permanent disability cancellations must use a revised form that includes the physician's state license number.
- A certified or original copy of the death certificate is required.
- Regulations published on November 1, 2000, require that a previous loan that had been discharged based on the disability of the borrower must be reinstated before the borrower can regain eligibility for new loans and grants if they return to school.
- The regulations also contain a provision for a three-year conditional period for loan disability discharges. Before the loan is permanently discharged, the Department will verify to determine if the borrower has earned income that exceeds a threshold based on the poverty level. If the borrower's income has exceeded the established threshold, the loan will be reinstated.

4. Citizenship Match

An OIG audit performed for award year 1992-93 determined that the citizen verification process allowed ineligible, non-U.S. citizens to receive Pell Grants totaling over \$70 million during award year 1992-93. We matched the applicants claiming U.S. citizenship against the citizenship status maintained by the Social Security Administration (SSA).

The ineligible non-citizens had indicated they were U.S. citizens on their applications. Although the Department verified the status of those applicants who marked on their applications they were non-U.S. citizens, the edit process did not verify the accuracy of applicants who indicated U.S. citizenship. The Department changed the edit process to match all applicants with the SSA.

We also have investigated cases involving false citizenship information. Recently, a university director of foreign students and two professors were indicted on 113 counts for conspiring to commit student visa fraud, allowing ineligible students to receive student financial assistance.

B. Identity Theft Fraud by Ineligible Students

Identity theft typically occurs on the FAFSA when a person intentionally uses someone else's name and Social Security number to fraudulently obtain student aid. People who obtain loans through identity theft almost always default on those loans. We have experienced an increase of these cases in recent years, and we have asked the Department to require that postsecondary institutions verify students' identity using picture identification, such as a driver's license.

C. Fraud by Financial Aid Consultants

We have investigated a number of financial aid consultants who submitted false FAFSAs and tax returns on behalf of their clients, enabling these clients to fraudulently qualify for aid. For example, we investigated a consultant who charged approximately \$300 for weekly seminars, advising and assisting parents and students in preparing FAFSAs that deliberately misstated their income. For this single case, we identified a potential loss to the government of \$800,000.

Our investigation of another financial aid consulting business led to 411 settlements and civil judgments totaling over \$4 million. The owner of this business certified false Federal income tax returns that contained false income amounts, enabling ineligible students to receive financial aid. We identified over 700 students who used this service.

D. Fraud and Abuse by Collection Agencies

A collection agency paid \$6.4 million in settlement of allegations that it submitted false claims for payment under its contract with the Department to collect defaulted student loans. The alleged false claims were based upon consolidated loans that did not meet legal requirements.

In an audit, we found that another collection agency owed more than \$800,000 to 177 schools. Our subsequent investigation of that collection agency's officials resulted in a restitution order of more than \$1 million because they used client trust funds for personal and operating expenses, instead of remitting the funds to clients. ("Review of Collection Activities at Unger and Associates", ED-OIG/ACN: A06-90011; February 2000)

E. Fraud Related to Foreign Schools

The regulations for foreign schools' participation in the Federal Family Education Loan (FFEL) program include fewer controls than those for domestic schools. FFEL funds are disbursed directly to students in foreign schools, while students in domestic schools receive FFEL funds through the schools they attend.

We have investigated many cases of individuals who apply for FFEL loans, receive the loan money, and never attend the foreign schools. Our investigations of foreign schools to date have resulted in restitution of over \$2 million. We have suggested that the Department require independent verification that the students are enrolled in the foreign schools before disbursing FFEL funds.

F. Fraud from Failure to Make Refunds

We have investigated cases in which schools deliberately failed to calculate or pay a student's refund of student financial assistance as required by law. We have suggested that the Department be alert for instances of this type of fraud when it conducts on-site reviews at high risk schools.

G. Waste and Abuse from Inadequate Monitoring

Our work has repeatedly documented instances of waste and abuse that have been allowed to continue because of inadequate monitoring. As we noted earlier, the student financial assistance programs are complex and have many participants, including lenders, schools, guaranty agencies, collection agencies, and financial aid consultants. More effective monitoring of these participants would reduce the waste and abuse that occurs in these programs. Some examples of our work documenting the need for increased monitoring follow.

1. Insufficient Program Review Monitoring

The Department is responsible for monitoring schools, guaranty agencies, and lenders. In an audit, we found that the number of on-site program reviews of schools dropped from 746 in fiscal year 1996 to 128 in fiscal year 1998. We also found that by fiscal year 1999, the average program review liability had dropped to \$4,624, from \$71,209 in fiscal year 1996. In response to our recommendation, the Department agreed to increase the number of program reviews at high risk institutions. ("Review of Case Management & Oversight's Program Review Function", ED-OIG/ACN: A04-90003; September 2000)

In the Management Letter accompanying the fiscal year 2002 Financial Statement Audit, the auditors noted that the Department performed only one program review at a lender during the year. There are approximately 4,000 lenders in the FFEL program.

2. Abuse by Guaranty Agencies

During the last two years, we performed audits on nine guaranty agencies to assess the adequacy of their establishments of the Federal and Operating funds required under the Higher Education Amendments of 1998. These audits identified approximately \$164 million that should be recovered by the Federal government, including:

- approximately \$48.3 million that was not transferred to the Federal funds, or inappropriate expenses from Federal funds;
- outstanding issues about the Federal interest in \$10.9 million in non-liquid assets remaining at several of the guaranty agencies; and
- approximately \$103 million in excess Federal funds at one guaranty agency that should have been recalled by the Department.

The Department's program reviews at the same nine guaranty agencies conducted during fiscal years 2001 and 2002 did not detect these monetary findings.

We audited only nine of the thirty-six guaranty agencies. Therefore, the potential exists for additional funds due to the Federal government from the remaining twenty-seven guaranty agencies we did not audit.

3. Abuse in Cash Management

We have completed several audits identifying institutions that did not disburse Pell grant and Direct Loan funds in accordance with student financial assistance program regulations. These institutions transferred funds to their operating accounts before identifying eligible students, as required under HEA. For example, we examined one institution that improperly kept over \$146,000 in interest on Direct Loan funds it deposited into a money market fund. We have recommended that the Department improve its monitoring, to help ensure that institutions disburse funds in compliance with regulations. ("Bennett College's Compliance with Cash Management and Refund Procedures for Department of Education Funds for the Period July 1, 1997, through June 30, 2000", ED-OIG/ACN: A04B0015; September 2002)

H. Waste from Use of Inaccurate Guidance

We alerted the Department that its Federal Student Aid Handbook contained inaccurate guidance that could result in schools disbursing student financial assistance to non-citizens who are not eligible for the aid. We found that the guidance the Department provided to schools on the interpretation of HEA's citizenship requirements was inconsistent and inaccurate. We estimated that this guidance contributed to the disbursement of approximately \$5.4 million in aid to more than 2,000 potentially ineligible students. The Department is revising its guidance.

IV. Corrective Actions Needed to Reduce Waste, Fraud, and Abuse

In recent years, the Department has focused on removing student financial assistance programs from GAO's high-risk list, and it has taken a number of management actions designed to achieve that goal. We believe the most immediate actions it needs to take to reduce waste, fraud, and abuse in the student financial assistance programs are to increase monitoring and to implement the IRS income match.

A. The Department Needs Authority to Implement the IRS Income Match

As I noted earlier, we have recommended implementation of an IRS income match since 1997, and the Department has been working with OMB and the Congress for additional authorizing legislation. We have documented, and the Department concurs, that significant improper payments could be prevented with this match. The estimate of Pell grants disbursed based upon understated income figures from the applicants is growing, from our \$177 million estimate for award year 1995-96, to the Department's current \$336 million estimate for fiscal year 2001. We urge Congress to enact the legislation necessary to implement the IRS match.

B. The Department Needs to Increase Monitoring

The Department needs to increase its monitoring of schools, lenders, guaranty agencies, and other participants in these programs. Increased monitoring is needed to improve the financial management of, and accountability for, Federal education expenditures. Vigorous program and contract monitoring helps ensure that Federal education dollars are used effectively and efficiently, and it reduces potential for waste, fraud, and abuse. GAO has also informed the Department that monitoring the effectiveness and sustainability of its corrective measures is necessary to remove student financial assistance programs from the high risk list.

Our audits have repeatedly cited deficiencies in the Department's oversight of schools, including a significant decrease in program reviews and inconsistent enforcement of financial responsibility. For example, as we discussed above, audits at nine guaranty agencies identified approximately \$164 million due to the government. These monetary findings were not detected by the Department in its program reviews of the same nine agencies.

GAO has also informed the Department that monitoring the effectiveness and sustainability of its corrective measures is necessary to remove the financial assistance programs from GAO's high-risk list.

We will continue to assist the Department in its efforts to reduce waste, fraud, and abuse, to safeguard Federal education dollars and help ensure that these funds reach the intended recipients.

